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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 20

[REG-130975-08]

RIN 1545-BI11

Guidance under Section 2053 Regarding Deduction for Interest Expense and Amounts Paid under a Personal Guarantee, Certain Substantiation Requirements, and Applicability of Present Value Concepts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document proposes to amend existing regulations issued under section 2053 of the Internal Revenue Code (Code). The proposed regulations provide guidance on the proper use of present-value principles in determining the amount deductible by an estate for funeral expenses, administration expenses, and certain claims against the estate. In addition, the proposed regulations provide guidance on the deductibility of interest expense accruing on tax and penalties owed by an estate, and interest expense accruing on certain loan obligations incurred by an estate. The proposed regulations also amend and clarify the requirements for substantiating the value of a claim against an estate that is deductible in certain cases. Finally, the proposed regulations provide guidance on the deductibility of amounts paid under a decedent's personal guarantee. The proposed regulations will affect estates of decedents seeking to deduct funeral expenses, administration expenses, and/or certain claims against the estate under section 2053. This document also provides a notice of a public hearing on these proposed regulations.

DATES: Electronic or written comments must be received by [**INSERT DATE 90 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER**]. The public hearing is being held by teleconference on October 12, 2022, at 10 a.m. EST. Requests to speak and outlines of topics to be discussed at the public hearing must be received by [**INSERT DATE 90 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER**]. If no outlines are received by [**INSERT DATE 90 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER**], the public hearing will be cancelled. Requests to attend the public hearing must be received by 5:00 p.m. EST on October 7, 2022. The telephonic hearing will be made accessible to people with disabilities. Requests for special assistance during the telephonic hearing must be received by October 6, 2022.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at www.regulations.gov (indicate IRS and REG-130975-08). Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The IRS expects to have limited personnel available to process comments that are submitted on paper through the mail. The IRS will publish any comments submitted electronically, and to the extent practicable, comments submitted on paper to the public docket. Send paper submissions to CC:PA:LPD:PR (REG-130975-08), Room 5205, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044.

For those requesting to speak during the hearing, send an outline of topic submissions electronically via the Federal eRulemaking Portal at www.regulations.gov (indicate IRS and REG-130975-08).

Individuals who want to testify (by telephone) at the public hearing must send an email to *publichearings@irs.gov* to receive the telephone number and access code for the hearing. The subject line of the email must contain the regulation number REG-130975-08 and the word TESTIFY. For example, the subject line may say: Request to TESTIFY at Hearing for REG-130975-08. The email should include a copy of the speaker's public comments and outline of topics. Individuals who want to attend (by telephone) the public hearing must also send an email to *publichearings@irs.gov* to receive the telephone number and access code for the hearing. The subject line of the email must contain the regulation number REG-130975-08 and the word ATTEND. For example, the subject line may say: Request to ATTEND Hearing for REG-130975-08. To request special assistance during the telephonic hearing, contact the Publications and Regulations Branch of the Office of Associate Chief Counsel (Procedure and Administration) by sending an email to *publichearings@irs.gov* (preferred) or by telephone at (202) 317-5177 (not a toll-free number).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Karlene Lesho or Melissa Liquerman at (202) 317-6859; concerning the submission of comments, the hearing, or to be placed on the building access list to attend the hearing, Regina Johnson at (202) 317-6901 (not toll-free numbers) or by sending an email to *publichearings@irs.gov*.

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

I. Overview

This document contains proposed amendments to the Estate Tax Regulations (26 CFR part 20) under section 2053.

Section 2001(a) imposes a tax on the transfer of the taxable estate of every decedent who was at death a citizen or resident of the United States. Section 2051 defines the taxable estate as the value of the gross estate less the deductions provided for in sections 2053 through 2058. Section 2031(a) describes the value of the gross estate of the decedent as including the value at the time of the decedent's death of all property, real or personal, tangible or intangible, wherever situated.

Under section 2053(a), for Federal estate tax purposes, the value of the taxable estate is determined by deducting from the value of the gross estate the following amounts that are allowable by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered: (1) funeral expenses, (2) administration expenses, (3) claims against the estate, and (4) unpaid mortgages on, or any indebtedness in respect of, property where the value of the decedent's interest therein, undiminished by such mortgage or indebtedness, is included in the value of the gross estate.

Final regulations amending the regulations under section 2053 (TD 9468) were published in the **Federal Register** (74 FR 53652) on October 20, 2009 (2009 Final Regulations). The 2009 Final Regulations generally limit the deduction for claims and expenses to the amount actually paid in settlement or satisfaction of that item, with exceptions for certain ascertainable amounts, claims against the estate, and indebtedness. See §20.2053-1(d)(1) and (4); §20.2053-4(b) and (c); and §20.2053-7. The 2009 Final Regulations also reserve §20.2053-1(d)(6) to provide future guidance on the issue of the appropriate application of present-value principles in determining the amount deductible under section 2053. These proposed regulations address this issue. In addition, these proposed regulations provide or clarify rules under section 2053 addressing the deductibility of interest expense accruing on tax and penalties owed by an estate, the deductibility of interest expense accruing on certain loan obligations incurred by an estate, requirements for substantiating the value of a claim against an estate that is deductible under §20.2053-4(b) or (c), and the deductibility of amounts paid under a decedent's personal guarantee.

II. Application of Present-Value Principles to Amount Deductible under Section 2053

A. Issue Background

"Present value" is a widely accepted principle of accounting for the time value of money. If a payor can defer paying a dollar until a later time, the payor can earn income on that dollar until the date of payment. The longer a payor can defer payment, the more income the payor potentially can earn. Taxpayers, the IRS, and courts regularly employ present-value principles for valuation and for other income tax and transfer tax purposes. See, e.g., section 1274(b), §§1.642(c)-6, 20.7520-1, and 25.2512-5; Simpson et al. v. United States, 252 U.S. 547 (1920); Commissioner v. Estate of Sternberger, 348 U.S. 187 (1955).

The deduction allowable under section 2053 eliminates from taxation under section 2001 that portion of the gross estate that the estate expends or necessarily will expend in paying certain expenses and liabilities of the estate and certain claims against the estate. The expended portions of the gross estate do not pass to the decedent's legatees, beneficiaries, or heirs and, therefore, are not subject to the estate tax. The 2009 Final Regulations implement these principles in determining the amount an estate may deduct for certain claims and expenses. Section 20.2053-1(d)(1) generally limits the deduction under section 2053 for certain claims and expenses to the total amount actually paid in settlement or satisfaction of that item. Section 20.2053-1(d)(2) clarifies that events occurring after the date of a decedent's death will be taken into consideration in determining the allowable deduction under section 2053.

Applying present-value principles to determine the allowable deduction under section 2053 for payments made or to be made after an extended period following a decedent's death is consistent with the principles underlying section 2053 and the approach of the 2009 Final Regulations. By limiting the deduction to the discounted amount of a payment or payments made or to be made after an extended period following the decedent's death, the gross estate is reduced by a more accurate measure of the amounts not passing to the heirs and legatees. Accordingly, the Department of the Treasury (Treasury Department) and the IRS have determined that limiting the amount deductible to the present value of the amounts paid after an extended post-death period will more accurately reflect the economic realities of the transaction, the true economic cost of that expense or claim, and the amount not passing to the beneficiaries of the estate. Moreover, consistent with the 2009 Final Regulations, this approach treats the date of payment of the otherwise deductible expense or claim as a post-death event properly taken into account under section 2053.

Rules applying present-value principles to certain long-term obligations were provided in proposed regulations (REG-143316-03) published in the **Federal Register** (72 FR 20080) on April 23, 2007 (2007 Proposed Regulations), which preceded the issuance of the 2009 Final Regulations. Specifically, the 2007 Proposed Regulations required the computation of the present value of future payments for a decedent's noncontingent recurring obligation, such as a noncontingent recurring obligation to pay an annuity amount under a property settlement agreement. See §20.2053-4(b)(7)(i) of the 2007 Proposed Regulations. However, that rule did not apply to contingent recurring obligations. Rather, amounts payable for a decedent's contingent recurring obligation became deductible only as amounts were paid by the estate in satisfaction of the claim and the amount deductible equaled the dollar amount actually paid. No computation of present value factored into the amount deductible for such obligations. See §20.2053-4(b)(7)(ii) of the 2007 Proposed Regulations.

The preamble to the 2009 Final Regulations indicated that the Treasury Department and the IRS found persuasive criticism of those proposed rules by commenters suggesting they produced an inconsistent and inequitable result. The 2009 Final Regulations clarified that the amount payable pursuant to a decedent's noncontingent recurring obligation is deemed ascertainable with reasonable certainty and, hence, deductible in advance of payment under the rule in §20.2053-1(d)(4), while the amount payable pursuant to a decedent's contingent recurring obligation is not ascertainable with reasonable certainty and, hence, the amount deductible is limited to amounts actually paid by the estate in satisfaction of the claim. See §20.2053-4(d)(6). However, the 2009 Final Regulations removed the present-value limitation applicable only to noncontingent recurring obligations and reserved §20.2053-1(d)(6) to provide future guidance on the issue.

With regard to a decedent's obligations that satisfy the requirements for deductibility as described in the preceding paragraph, whether such obligations are recurring or nonrecurring, there is no persuasive technical or policy basis for limiting the application of present-value principles to payments made or to be made only under noncontingent obligations. Because discounting the amounts actually paid or to be paid in the future to determine the present value of the payments is consistent with the purpose of section 2053 of reducing the gross estate only by the amounts not passing to the heirs and legatees, these proposed regulations propose to incorporate present-value principles in determining the amount deductible under section 2053. The proposed regulations will apply present-value principles consistently to expenses and claims (whether contingent or noncontingent) that are deductible under section 2053. The mechanics of applying present-value principles to expenses and claims, including expenses and claims that are deductible in advance of payment, are described in section II.B of this Background and Explanation of Provisions.

B. Explanation of Provision

The Treasury Department and the IRS propose to amend the regulations under section 2053 to incorporate present-value principles in determining the amount deductible under section 2053 for claims and expenses (excluding unpaid mortgages and indebtedness deductible under §20.2053-7). The Treasury Department and the IRS recognize, however, that estates often cannot pay every deductible claim and expense within a short time after the decedent's death and that sound tax administration should balance the benefit of more accurately determining the amounts not passing to the beneficiaries of an estate garnered from applying present-value principles with the administrative burden of applying those principles to deductible claims and expenses that occur during a reasonable period of administration of the estate. The Treasury Department and the IRS understand that a significant percentage of estates pay most, if not all, of their ordinary estate administration expenses during the three-year period following the decedent's date of death. This three-year period takes into account a reasonable time for administering and closing the estate. The Treasury Department and the IRS note that a reasonably short period of time between the decedent's death and the payment of a claim prevents the lack of a present-value discount from significantly distorting the value of the net (distributable) estate. Applying present-value principles in computing the deductible amount of those claims and expenses paid more than three years after the decedent's death strikes an appropriate balance between benefits and burdens.

Accordingly, the Treasury Department and the IRS propose to amend the regulations under section 2053 to require the discounting to present value of certain amounts paid or to be paid in settlement or satisfaction of certain claims and expenses in determining the amount deductible under section 2053. Specifically, the rule in these proposed regulations requires calculating the present value of the amount of a deductible claim or expense described in section 2053(a) and §20.2053-1(a) that is not paid or to be paid on or before the third anniversary of the decedent's date of death, which three-year period the proposed regulations define as the "grace period." The proposed regulations provide the general formula for calculating the present value of such amounts and state that the discount rate to be used in the calculation is the applicable Federal rate determined under section 1274(d) for the month in which the decedent's date of death occurs, compounded annually. The length of time from the decedent's death to the date of payment or expected date of payment will determine whether the Federal rate applicable to that amount is the Federal mid-term rate or the Federal long-term rate. The proposed regulations provide that any reasonable assumptions or methodology in regard to time period measurements may be used in calculating the present value. In addition, the proposed regulations require a supporting statement to be filed with the Form 706 showing any calculations of present value.

The proposed regulations explain how to calculate present value when the amount of a claim or expense is deductible in advance of the payment of such amount, as under §§20.2053-1(d)(4) and 20.2053-4(b) and (c). The proposed regulations provide that the expected date or dates of payment will be used in computing present value and that the expected date or dates of payment will be determined by making a fair and reasonable estimate using all information reasonably available to the taxpayer. For amounts deductible under §20.2053-4(b) and (c), the proposed regulations provide that the expected date or dates of payment must be identified in a written appraisal document. Consistent with the rule in §20.2053-1(d)(2), which takes into consideration events occurring during the post-death period described in that section, the proposed regulations also provide that the computation of present value is subject to adjustment if the actual date of payment differs from the estimate used.

III. Deductibility of Interest Expense as Administration Expense

A. Issue Background

Section 2053(a)(2) allows an estate to deduct from the value of the gross estate the amount of administration expenses that are allowable by the law of the jurisdiction in which the estate is being administered. In some cases, interest expense incurred by an estate may be a deductible administration expense under section 2053(a)(2) if the facts support a finding that the expense satisfies the requirements of section 2053 and the regulations thereunder. Several statutory and regulatory provisions are relevant to the deductibility of interest as an administration expense under section 2053(a)(2).

First, effective for decedents dying after December 31, 1997, section 2053(c)(1)(D) provides that, "no deduction shall be allowed under [section 2053] for any interest payable under section 6601 on any unpaid portion of the [Federal estate tax] for the period during which an extension of time for payment of such tax is in effect under section 6166."

Second, §20.2053-3(a) provides that the amounts deductible from a decedent's gross estate as administration expenses under section 2053(a)(2) are limited to such expenses that actually and necessarily are incurred in the administration of the decedent's estate. The expenses contemplated in the law are those that are associated with the settlement of an estate and the transfer of the property of the estate to individual beneficiaries or to a trustee. Expenditures not essential to the proper settlement of the estate, but incurred for the individual benefit of the heirs, legatees, or devisees, may not be taken as deductions.

Third, §20.2053-1(b)(2) provides that only expenses that are bona fide in nature are deductible under section 2053. Section 20.2053-1(b)(2) applies to any amounts deductible under section 2053(a) and (b), including deductible administration expenses.

The issue of the extent to which and the circumstances under which interest expense satisfies the requirements for a deductible administration expense under section 2053(a)(2) and the regulations thereunder is longstanding. Over the past half century, a number of litigated cases and sub-regulatory published guidance items have provided some clarity on the legal issues surrounding the ability to deduct, as an administration expense under section 2053(a)(2), interest accruing on deferred tax and penalties and on loan obligations incurred by an estate. Litigation on this fact-driven issue continues in regard to interest accruing on loan obligations incurred by an estate.

The Treasury Department and the IRS consider it appropriate to amend the regulations under section 2053 to address specifically the issue of interest expense as a deductible administration expense under section 2053(a)(2). In particular, the Treasury Department and the IRS propose to address interest expense accruing after the death of the decedent on any unpaid portion of tax or penalties and on a loan obligation incurred by the estate to pay estate taxes or other estate expenses.

B. Explanation of Provisions

1. Interest Accruing on Unpaid Tax and Penalties

In general, interest is payable at the underpayment rate in section 6621 on (i) any amount of unpaid Federal tax, and (ii) any unpaid additions to tax, additional taxes, and penalties (such interest referred to in this preamble as "section 6601 interest" and such additions to tax, additional taxes, and penalties collectively referred to in this preamble as "penalties"). See section 6601(a) and (e)(2). However, interest payable under section 6601 on unpaid estate tax deferred under section 6166 (which includes interest accruing on any such deferred payment during any period when an extension of time for payment is in effect under section 6161(a)(2)(B) with respect to that payment) (referred to in this preamble as "section 6166 interest") is subject to a more favorable interest rate under section 6601(j), and section 2053(c)(1)(D) provides that such interest is not deductible. The statutory prohibition of a deduction for section 6166 interest does not apply to "non-section 6166 interest," defined for purposes of this preamble as any section 6601 interest other than section 6166 interest and interest payable on any unpaid portion of state tax and penalties pursuant to state law. Thus, non-section 6166 interest that accrues on and after the decedent's date of death may qualify as a deductible administration expense under section 2053(a)(2).

To determine the deductibility of non-section 6166 interest accruing on and after the decedent's date of death, the existing regulatory requirements in §§20.2053-1(b)(2) and 20.2053-3(a) apply. Non-section 6166 interest satisfies the "bona fide" requirement in §20.2053-1(b)(2) because such interest accrues pursuant to either Federal or state law. Non-section 6166 interest may satisfy the "actually and necessarily incurred" requirement in §20.2053-3(a), but such determination depends on the facts and circumstances.

Non-section 6166 interest may accrue on and after the date of a decedent's death on unpaid estate tax in connection with an extension granted under section 6161 (but not under section 6161(a)(2)(B)) or a deferral elected under section 6163. A section 6161 extension is granted upon a showing of reasonable cause for extending the time for payment. A section 6163 deferral is appropriate when the value of a reversionary or remainder interest is includible in the gross estate, but such value is not immediately available for payment of the estate tax. The nature of both section 6161 extensions and section 6163 deferrals indicates they are based on a demonstrable need to defer payment. Accordingly, the Treasury Department and the IRS have determined that interest payable under section 6601 on unpaid estate tax in connection with an extension under section 6161 or a deferral under section 6163 is necessarily incurred in the administration of the estate.

Non-section 6166 interest may accrue on and after the date of a decedent's death on unpaid tax and penalties in connection with an underpayment of tax or a deficiency (as that term is defined in section 6211). In many cases, such interest and the underlying underpayment of tax or deficiency is attributable to the reasonable exercise of an executor's fiduciary duties in administering the estate, as may occur in cases involving legitimate disagreements with the IRS, inadvertent errors, or reasonable reliance on a qualified professional. The Treasury Department and the IRS have determined that, generally, such interest is actually and necessarily incurred in the administration of the estate. However, the Treasury Department and the IRS are concerned that there are some circumstances in which such interest expense would not satisfy the "actually and necessarily incurred" requirement in §20.2053-3(a). For instance, when non-section 6166 interest accrues on unpaid tax and penalties in connection with an underpayment of tax or deficiency and the underlying underpayment or deficiency is attributable to an executor's negligence, disregard of the rules or regulations (including careless, reckless, or intentional disregard of rules or regulations) as defined in §1.6662-3(b)(2), or fraud with intent to evade tax, the interest expense is not an expense actually and necessarily incurred in the administration of the estate. Accordingly, the Treasury Department and the IRS have determined that, when interest accrues on any unpaid tax or penalty and the interest expense is attributable to an executor's negligence, disregard of the rules or regulations, or fraud with intent to evade tax, the interest expense is neither actually and necessarily incurred in the administration of the estate nor essential to the proper settlement of the estate. Further, the Treasury Department and the IRS have determined that the rationale underlying this determination applies to all non-section 6166 interest, whether the interest accrues in connection with a deferral, underpayment, or deficiency.

The proposed regulations amend the regulations under section 2053 to confirm that section 6166 interest on estate tax deferred under section 6166, including interest accruing on an installment under section 6166 during the period of an extension of time for payment under section 6161(a)(2)(B), is not a deductible administration expense under section 2053. The proposed regulations also provide that non-section 6166 interest that accrues on or after the decedent's date of death on any unpaid tax or penalties may be deductible to the extent permitted by §§20.2053-1 and 20.2053-3(a). The proposed regulations further provide that non-section 6166 interest on estate tax deferred under section 6161 or section 6163 is actually and necessarily incurred in the administration of the estate because the grant of the extension was based on a demonstrated need to defer payment. Finally, the proposed regulations provide that, in general, non-section 6166 interest accruing post-death on any unpaid tax or penalties in connection with an underpayment of tax or a deficiency is actually and necessarily incurred in the administration of the estate. However, the proposed regulations provide that, notwithstanding these rules, non-section 6166 interest accruing on unpaid tax and penalties on and after the decedent's date of death, whether in connection with a deferral, underpayment, or deficiency, is not actually and necessarily incurred in the administration of the estate and is not deductible to the extent the interest expense is attributable to an executor's negligence, disregard of applicable rules or regulations (including careless, reckless, or intentional disregard of rules or regulations) as defined in §1.6662-3(b)(2), or fraud with intent to evade tax. Interest expense is attributable to an executor's negligence, disregard of applicable rules or regulations, or fraud with intent to evade tax to the extent that the underlying underpayment, deficiency, or penalty is attributable to such conduct by the executor. Similarly, even when the underlying underpayment, deficiency, or penalty is not attributable to such conduct by the executor, interest expense is attributable to an executor's negligence, disregard of applicable rules or regulations, or fraud with intent to evade tax to the extent the subsequent accrual of interest is attributable to such conduct by the executor.

The rules in the proposed regulations pertaining to whether non-section 6166 interest satisfies the requirement in §20.2053-3(a) supplant the rule reflected in Rev. Rul. 79-252, 1979-2 C.B. 333, and in the second holding of Rev. Rul. 81-154, 1981-1 C.B. 470. (<u>See</u> §601.601(d)(2)(ii)(<u>b</u>).) Together, these two holdings create an implicit presumption that interest accruing on any unpaid portion of tax or penalties in all cases satisfies the requirements for a deductible administration expense, which is inconsistent with the requirement in §20.2053-3(a) that the expense be actually and necessarily incurred in the administration of the estate.

2. Interest Accruing on Certain Loan Obligations Incurred by an Estate

The same requirements that apply for deductible interest accruing on unpaid tax and penalties also apply for deductible interest accruing on loan obligations incurred by an estate. Interest accruing on a loan obligation incurred by an estate satisfies the "bona fide" requirement in §20.2053-1(b)(2) when both the interest expense and the loan underlying the interest expense are bona fide in nature and do not constitute a transfer that is essentially donative in character. Such interest satisfies the "actually and necessarily incurred" requirement in §20.2053-3(a) when the loan on which the interest expense accrues and its terms are necessary to the administration of the decedent's estate and are essential to the proper settlement of the decedent's estate.

Among the reasons an estate might enter into a loan arrangement is to facilitate the payment of the estate's taxes and other liabilities or the administration of the estate. Some estates face genuine liquidity issues that make it necessary to find a means to satisfy their liabilities, and incurring a loan obligation on which interest accrues may be the only or best way to obtain the necessary liquid funds. However, if illiquidity has been created intentionally (whether in the estate planning, or by the estate with knowledge or reason to know of the estate tax liability) prior to the creation of the loan obligation to pay estate expenses and liabilities, the underlying loan may be bona fide in nature but most likely will not be found to be actually and necessarily incurred in the administration of the estate.

The issue of the deductibility of interest expense accruing on a loan obligation incurred by an estate has been litigated often, with varying results. See, e.g., Estate of Black v. Commissioner, 133 T.C. 340 (2009); Estate of Graegin v. Commissioner, T.C. Memo. 1988-477. In order to provide guidance on the deductibility of interest accruing on a loan obligation entered into by the decedent's estate to facilitate the payment of the estate's taxes and other liabilities or the administration of the estate, the Treasury Department and the IRS propose to amend the regulations under section 2053. The proposed regulations provide that interest expense is deductible only if: (i) the interest accrues pursuant to an instrument or contractual arrangement that constitutes indebtedness under applicable income tax regulations and general principles of Federal tax law; (ii) both the interest expense and the loan on which interest expense accrues satisfy the requirement of §20.2053-1(b)(2) that they are bona fide in nature; and (iii) the loan on which interest accrues and the loan's terms are actually and necessarily incurred in the administration of the decedent's estate and are essential to the proper settlement of the decedent's estate (within the meaning of §20.2053-3(a)).

Finally, the proposed regulations include a nonexclusive list of factors to consider in determining whether interest expense payable pursuant to such a loan obligation of an estate satisfies the requirements of §§20.2053-1(b)(2) and 20.2053-3(a). In general, the factors suggest that interest accruing on a loan obligation may satisfy these requirements when the loan and its underlying terms are reasonable and comparable to an arms-length loan transaction and correspond to the estate's ability to satisfy the loan, and the loan obligation is entered into by the executor with a lender who is not a substantial beneficiary of the decedent's estate (or an entity controlled by such a beneficiary) at a time when there is no viable alternative to obtain the necessary liquid funds to satisfy estate liabilities. In addition to providing guidance on when interest accruing on a loan obligation may satisfy the requirements of §§20.2053-1(b)(2) and 20.2053-3(a), the list of factors may suggest when the opposite is true and interest accruing on a loan obligation does not satisfy these requirements. For instance, if, taken in their entirety, the facts and circumstances indicate that either the need for the loan or any of the loan terms are contrived to generate, or increase the amount of, a deduction for the interest expense, the interest is not deductible. Thus, if the lender is a primary beneficiary of the estate (or an entity controlled by such beneficiary) who may have liability for payment of the estate tax or whose share of the estate may bear the burden of estate taxes and other liabilities, the facts indicate the loan is not necessarily incurred in the administration of the estate and, therefore, indicate that any interest accruing on the loan is not necessarily incurred in the administration of the estate. Further, if the loan obligation carries an extended loan term with a single balloon payment that does not correspond with the estate's ability to satisfy the loan, the facts indicate that the interest accruing on the loan is not necessarily incurred in the administration of the estate.

IV. Substantiation Requirements for Valuations Performed Pursuant to §20.2053-4(b) and (c)

A. Issue Background

Section 20.2053-4(b) and (c) provides exceptions to the general rule in §20.2053-4(a) that an estate may deduct only amounts that actually are paid by the estate in satisfaction of a claim. Section 20.2053-4(b) generally allows a deduction for the value of claims and counterclaims in a related matter, and §20.2053-4(c) allows a deduction for the value of unpaid claims totaling not more than $500,000. In each case, certain requirements must be satisfied to enable the estate to use these exceptions.

One such requirement is that the value of a claim against the estate that may be deducted under either §20.2053-4(b) or (c) must be determined from a "qualified appraisal" performed by a "qualified appraiser" within the meaning of section 170 and the regulations thereunder. The Treasury Department and the IRS have reconsidered this requirement. The definition of "qualified appraiser" and "qualified appraisal" in the regulations under section 170 were drafted in the context of appraising an asset being donated, and not a liability such as a claim against an estate. Certain of the elements of a qualified appraisal, including references to the "date of contribution," and the requirements necessary to meet the definition of a "qualified appraiser," do not apply in the context of valuing a claim against an estate for purposes of determining the value to be deducted from the gross estate under section 2053.

The Treasury Department and the IRS have determined that the rule in §20.2053-4(b) and (c) should be amended to remove the requirement that the value be determined by a "qualified appraisal" performed by a "qualified appraiser" within the meaning of section 170 and the regulations thereunder. Instead, the Treasury Department and the IRS propose to amend the regulations under section 2053 to provide revised rules for valuing claims for purposes of §20.2053-4(b) and (c).

B. Explanation of Provision

The Treasury Department and the IRS propose to amend the regulations under section 2053 to remove the requirement in §20.2053-4(b)(1)(iv) and (c)(1)(iv) that valuations of the claims deductible under §20.2053-4(b) and (c) must be supported by a "qualified appraisal" performed by a "qualified appraiser." For purposes of determining the allowable deduction under §20.2053-4(b) and (c), these proposed regulations instead provide new requirements intended to facilitate the appropriate valuation of these claims.

Specifically, to determine the current value of a claim deductible under §20.2053-4(b) or (c), the proposed regulations require a written appraisal that adequately reflects the current value of the claim when the Form 706 is being completed. The current value of the claim should take into account post-death events occurring prior to the time a deduction is claimed as well as those events reasonably anticipated to occur. In addition, the proposed regulations require the written appraisal to consider all relevant facts and elements of value that are known or that can be reasonably anticipated at the time of the appraisal. The written appraisal must be prepared, signed, and dated by a person who is qualified to appraise the claim being valued, but who is not (i) a family member of the decedent, a related entity as to the decedent, or a beneficiary of the decedent's estate or revocable trust (as those terms are defined in §20.2053-1(b)(2)(iii)), (ii) a family member of a beneficiary or a related entity as to a beneficiary (as those terms would be defined in §20.2053-1(b)(2)(iii) if references therein to the decedent were replaced with a reference to such beneficiary, and without the limitations based on the decedent's date of death), or (iii) an employee or other owner of any of them. The appraisal also must include a statement describing the basis for the person's qualification to appraise the claim being valued.

V. Deductibility of Amounts Paid Pursuant To Decedent's Personal Guarantee

A. Issue Background

A commenter responding to the 2007 Proposed Regulations suggested that the final regulations confirm that payments made pursuant to a decedent's personal guarantee existing at the decedent's death are deductible in the same manner as payments made in satisfaction of any other deductible claim against a decedent's estate.

For payments made pursuant to a decedent's obligation as a guarantor of indebtedness to be deductible, the claim must represent a personal obligation of the decedent existing at the time of the decedent's death, and the claim must be enforceable against the decedent's estate. See §20.2053-4(a)(1). However, not all enforceable debts are deductible under section 2053. A claim founded upon a decedent's guarantee is considered a claim founded upon a promise or agreement. Accordingly, the deduction for such a claim is limited to the extent that the guarantee was contracted bona fide and in exchange "for an adequate and full consideration in money or money's worth." See section 2053(c)(1)(A) and §20.2053-4(d)(5). For a claim founded upon a decedent's guarantee to satisfy the "adequate and full consideration in money or money's worth" requirement and, therefore, be deductible under section 2053, the decedent must have received a benefit reducible to money value in exchange for the decedent's guarantee. See United States v. Stapf, 375 U.S. 118, 131 (1963) ("Absent such an . . . augmentation of the estate, a testator could disguise transfers as payments in settlement of debts and claims and thus obtain deductions for transmitting gifts."); Commissioner v. Wemyss, 324 U.S. 303 (1945) (construing the requirement of "adequate and full consideration in money or money's worth" in the gift tax context to require a benefit to the donor reducible to money value "to relieve a transfer by him from being a gift."); Estate of Theis v. Commissioner, 81 T.C. 741, 745, 748 (1983) (noting the amounts at issue must have been contracted bona fide and for full and adequate consideration), aff'd 770 F.2d 981 (11th Cir. 1985).

Guarantor agreements often are required in the context of a loan to the guarantor's closely-held business. In these cases, the guarantor may be motivated to enter into the guarantee agreement to preserve the value of the guarantor's interest in the business. The Treasury Department and the IRS have determined that it is appropriate to provide guidance on whether, for purposes of section 2053, a guarantor agreement is contracted for an adequate and full consideration in money or money's worth in such a situation for purposes of section 2053.

When payments pursuant to a decedent's guarantee satisfy the requirements for a deductible claim, the amount deductible is limited to the portion of the total claim due from and actually paid by the estate, but reduced by the amount recovered, or the amount that could have been recovered, from another party, insurance, or otherwise. See §§20.2053-1(d)(1) and (3) and 20.2053-4(d)(3). Further, to avoid the double-counting of a debt that occurs when the debt both is taken into account in computing the gross estate and is taken as a section 2053 deduction, payments made pursuant to the decedent's guarantee are deductible only to the extent that the debt for which the guarantee is given has not been taken into account in computing the value of an asset includible in the decedent's gross estate.

A regulatory provision specifically addressing the deductibility of claims founded upon a decedent's guarantee will assist taxpayers in understanding and meeting their tax responsibilities and will result in consistent treatment for similarly situated taxpayers.

B. Explanation of Provision

The proposed regulations provide that a claim founded upon the decedent's agreement to personally guarantee a debt of another is a claim founded on a promise and, accordingly, must satisfy the applicable requirements in section 2053(c)(1)(A) and §20.2053-4(d)(5). Specifically, the guarantee must have been bona fide and in exchange for adequate and full consideration in money or money's worth. The proposed regulations confirm that the bona fide nature of a claim related to the guarantee of a debt of a family member, a related entity, or a beneficiary will be determined with reference to §20.2053-1(b)(2)(ii). The proposed regulations provide a bright line rule that a decedent's agreement to guarantee a bona fide debt of an entity in which the decedent had control (within the meaning of section 2701(b)(2)) at the time of the guarantee satisfies the requirement that the agreement be in exchange for adequate and full consideration in money or money's worth. Alternatively, the proposed regulations provide that this requirement also is satisfied if, at the time the guarantee is given, the maximum liability of the decedent under the guarantee did not exceed the fair market value of the decedent's interest in the entity. Finally, the proposed regulations provide that the estate's right of contribution or reimbursement will reduce the amount deductible in accordance with §20.2053-1(d)(3).

Proposed Applicability Date

The regulations are proposed to apply to the estate of each decedent dying on or after the date of publication in the **Federal Register** of a Treasury decision adopting these rules as final regulations.

Effect on Other Documents

Rev. Rul. 79-252 (1979-2 C.B. 333) states that interest on a Federal estate tax deficiency is a necessary administration expense under section 2053(a)(2) and is deductible to the extent allowable under local law. Rev. Rul. 81-154 (1981-1 C.B. 470) states, in the second holding, that interest incurred because of a late payment of tax is deductible under section 2053(a)(2) to the extent it is allowable under local law. Rev. Rul. 79-252 will be obsoleted and Rev. Rul. 81-154 will be modified, effective as of the date that a Treasury decision adopting these rules as final regulations is published in the **Federal Register**.

Statement of Availability of IRS Documents

IRS revenue procedures, revenue rulings, notices, and other guidance cited in this document are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at https://www.irs.gov.

Special Analyses

<u>Regulatory Planning and Review</u>

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations. Therefore, a regulatory impact assessment is not required.

<u>Regulatory Flexibility Act</u>

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations primarily affect estates of a decedent which generally are not small entities under the Act. Accordingly, these regulations are not expected to have a significant economic impact on a substantial number of small entities, and a regulatory flexibility analysis is not required.

Pursuant to section 7805(f) of the Code, these proposed regulations will be submitted to the Chief Counsel for the Office of Advocacy of the Small Business Administration for comment on their impact on small businesses.

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)), under Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, and assigned control number 1545-0015. Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, and to Clearance Officer, SE:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. Comments are specifically requested concerning:

Whether the proposed collections of information are necessary for the proper performance of the functions of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs of operation, maintenance, and purchase of services to provide information.

The collections of information in these proposed regulations are in proposed §§20.2053-1(d)(6)(iv) and 20.2053-4(b)(1)(iv) and (c)(1)(iv). The information requested in §20.2053-1(d)(6)(iv) is necessary in order to evaluate whether an estate is entitled to a deduction in the amount claimed on Form 706. The collection of information is mandatory to obtain a benefit. The information requested in §20.2053-4(b)(1)(iv) and (c)(1)(iv) is necessary in order to evaluate whether an estate is entitled to a deduction claimed on Form 706 and, if so, the amount of the deduction. The collection of information is mandatory to obtain a benefit. The likely respondents are estates of decedents seeking to deduct on Form 706 funeral expenses, administration expenses, and/or certain claims against the estate under section 2053.

Estimated total annual reporting burden: 23,661 hours.

Estimated average annual burden per respondent: 3 hours.

Estimated number of respondents: 7,887.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law.

Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of $100 million (updated annually for inflation). This proposed rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

Executive Order 13132: Federalism

E.O. 13132, titled “Federalism,” prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the E.O. This proposed rule does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the E.O.

Drafting Information

The principal authors of these regulations are Karlene Lesho and Melissa Liquerman, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the Treasury Department and the IRS participated in their development.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** section. The Treasury Department and the IRS request comments on all aspects of the proposed regulations.

Any electronic comments submitted, and to the extent practicable, any paper comments submitted, will be made available at www.regulations.gov or upon request.

A public hearing is being held by teleconference on October 12, 2022, at 10:00 a.m. EST unless no outlines are received by **[INSERT DATE 90 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to comment by telephone at the hearing must submit electronic or written comments and an outline of the topics to be discussed and the time to be devoted to each topic by **[INSERT DATE 90 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]** as prescribed in the preamble under the **ADDRESSES** section. A period of ten minutes will be allotted to each person for making comments (although this rule may be waived in unusual circumstances or for good cause shown). After the deadline for receiving outlines has passed, the IRS will prepare an agenda containing the schedule of speakers. Copies of the agenda will be made available at *www.regulations.gov*, search IRS and REG-130975-08. Copies of the agenda will also be available by emailing a request to *publichearings@irs.gov*. Please put "REG-130975-08 Agenda Request" in the subject line of the email.

Announcement 2020-4, 2020-17 IRB 667 (April 20, 2020), provides that until further notice, public hearings conducted by the IRS will be held telephonically. Any telephonic hearing will be made accessible to people with disabilities.

List of Subjects in 26 CFR Part 20

Estate taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, the IRS proposes to amend 26 CFR part 20 as follows:

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Paragraph 1. The authority citation for part 20 continues to read in part as follows:

Authority: 26 U.S.C. 7805.

* * * * *

Par. 2. Section 20.2053-1 is amended by:

1. Adding paragraph (d)(6).

2. Revising the introductory text of paragraph (d)(7).

3. In paragraph (d)(7), Examples 1 through 3 are designated as paragraphs (d)(7)(i) through (iii), respectively.

4. In newly designated paragraphs (d)(7)(i) and (ii):

i. Removing "ascertainable," and adding "ascertainable." in its place.

ii. Adding a sentence to the end of the paragraphs.

5. In newly designated paragraph (d)(7)(iii):

i. Removing "deduction," and "Example 2" and adding "deduction." and "paragraph (d)(7)(ii) of this section (Example 2)" in their places, respectively.

ii. Revising the last sentence of the paragraph.

6. Adding paragraphs (d)(7)(iv) through (vi).

7. Revising paragraph (f).

The additions and revisions read as follows:

§20.2053-1 Deductions for expenses, indebtedness, and taxes; in general.

* * * * *

(d) * * *

(6) Limitation on amount deductible--(i) Claims and expenses paid after the grace period--(A) Definitions. The following definitions apply for purposes of this paragraph (d):

(1) Grace period. The grace period is the period beginning on the date of the decedent's death and extending through the third anniversary of that date.

(2) Post-grace-period payment. A post-grace-period payment is the amount of a claim or expense described in paragraph (a) of this section not paid or to be paid before the end of the grace period.

(B) General rule. To the extent that a post-grace-period payment otherwise meets the requirements for deductibility of a claim or expense under section 2053 and the regulations in this part thereunder, the amount deductible under section 2053 is limited to the present value, as of the decedent's date of death, of that amount. The present value of each post-grace-period payment is calculated by discounting it from the payment date or expected date of payment to the decedent's date of death. The applicable discount rate is the applicable Federal rate determined under section 1274(d) for the month in which the decedent's death occurs, compounded annually. The length of time from the decedent's date of death to the date of payment or expected date of payment will determine whether the Federal rate applicable to that payment is the Federal mid-term rate or the Federal long-term rate. The Internal Revenue Service publishes the applicable Federal rates for each month in the Internal Revenue Bulletin (see §601.601(d)(2)(ii) of this chapter). Any reasonable assumptions and methodology in regard to time period measurements may be used to calculate, in accordance with paragraph (d)(6)(ii) of this section, the present value of the post-grace-period payment(s).

(ii) Calculating present value of amounts paid or payable--(A) Single post-grace-period payment. The amount deductible under section 2053 for a single post-grace-period payment is computed by calculating the present value of such payment as follows:

$$\text{Amount of future payment x } [1 \div (1+i)]^{t}$$

Where:

t is the amount of time (expressed in years and fractions of years) from the day after the decedent's date of death to the payment date or expected date of payment; and

i is the applicable discount rate.

(B) Multiple post-grace-period payments. The amount deductible under section 2053 for multiple post-grace-period payments is computed by calculating the present value of each such payment using the formula in paragraph (d)(6)(ii)(A) of this section; the sum of the discounted amounts of the post-grace-period payments is the amount that is deductible for such payments.

(C) Multiple payment dates occurring during and after the grace period. A claim or expense described in paragraph (a) of this section may have at least one payment date or expected date of payment during the grace period and at least one payment date or expected date of payment after the grace period. For such a claim or expense, the amount deductible under section 2053 is computed by calculating the present value of each separate post-grace-period payment using the formula in paragraph (d)(6)(ii)(A) of this section, and adding the total of these discounted amounts to any amount of the claim or expense having a payment date or expected date of payment during the grace period. Any amount having a payment date or expected date of payment during the grace period is not discounted in arriving at the amount deductible.

(iii) Discounting when actual date of payment is unknown. With regard to a post-grace-period payment that may be deducted in advance of payment under paragraph (d)(4) of this section or §20.2053-4(b) or (c), the amount deductible must be determined by computing the present value of the amount of that post-grace-period payment as if that amount will be paid on the expected date of payment. The expected date of payment in settlement or satisfaction of a claim or expense must be determined using all information reasonably available to the taxpayer to make a fair and reasonable estimate of the expected date or dates of payment. For amounts deductible under §20.2053-4(b) or (c), the expected date or dates of payment must be identified in a written appraisal document of a person that is qualified by knowledge and experience to appraise the claim being valued. See §20.2053-4(b)(1)(iv) and (c)(1)(iv). However, the computation of present value is subject to adjustment if, within the period described in paragraph (d)(2) of this section, the actual date or dates of payment become known and differ from the estimated date or dates of payment. See paragraph (d)(6)(vi) of this section.

(iv) Statement supporting present value computation required. A deduction under section 2053 for a claim or expense that is required to be discounted to present value under paragraph (d)(6)(i) of this section must be supported by a statement to be filed with the Form 706 showing the computation of the present value of that item, including, if applicable, the basis for the determination of the expected date(s) of payment.

(v) Ordering rule. In computing the amount deductible for a claim or expense under paragraph (d) of this section, the amount deductible for a claim or expense (otherwise determined under paragraphs (d)(1) through (4) of this section) is discounted to present value under paragraph (d)(6) of this section before applying the limits in §20.2053-4(b)(2) and (c).

(vi) Effect of post-death events. If a deduction is claimed for the present value of a post-grace-period payment, the claimed deduction is subject to adjustment to reflect any post-death events affecting the amount of such post-grace-period payment and any change in the expected or actual date of payment. See paragraph (d)(2) of this section for the period during which post-death events are taken into account.

(vii) Exceptions. The rule in paragraph (d)(6)(i) of this section does not apply to unpaid principal of mortgages and other indebtedness deductible under §20.2053-7.

(7) Examples. Assume that the amounts described in section 2053(a) are payable out of property subject to claims and are allowable by the law of the jurisdiction governing the administration of the estate, whether the applicable jurisdiction is within or outside of the United States. Assume that, unless otherwise provided, the claims against the estate are not deductible under §20.2053-4(b) or (c) and all amounts are paid during the grace period. The following examples illustrate the application of this paragraph (d):

(i) * * * However, any amounts that will not be paid on or before the third anniversary of the date of D's death (that is, are not paid during the grace period) are subject to the present value limitation in paragraph (d)(6) of this section.

(ii) * * * If the amount of the claim will not be paid on or before the third anniversary of the date of D's death (that is, the amount is not paid during the grace period), the amount deductible is subject to the present value limitation in paragraph (d)(6) of this section.

(iii) * * * At that time, a deduction will be allowed for the amount that is either paid or meets the requirements of paragraph (d)(4) of this section for deducting certain ascertainable amounts, subject to the present value limitation in paragraph (d)(6) of this section, if applicable.

(iv) Example 4: Discounting amount paid more than three years after decedent's date of death. The facts are the same as in paragraph (d)(7)(ii) of this section (Example 2) except that E files a timely protective claim for refund in accordance with paragraph (d)(5) of this section to preserve the estate's right to claim a refund, a final judgment in the amount of $100x is entered against and paid by the estate precisely five years after D's date of death, and the applicable Federal (mid-term) rate determined under section 1274(d) for the month in which D's date of death occurs, compounded annually, is 2.00%. Within a reasonable period of time after the final judgment is entered, E notifies the Commissioner that the contingency has been resolved. E may claim a deduction for the present value of the amount paid in satisfaction of the claim as of D's date of death. Under the facts in this paragraph (d)(7)(iv), the present value of the amount paid in five years equals $\$100x / (1 + .0200)^5$ or $100x/1.104081 or $90.57x.

(v) Example 5: Discounting amount to be paid when actual date of payment not known. The facts are the same as in paragraph (d)(7)(ii) of this section (Example 2) except that the claim is deductible under §20.2053-4(c) because all amounts deducted by the estate under that paragraph do not exceed $500,000. E obtains a written appraisal document meeting the requirements of §20.2053-4(c)(iv) and reasonably determines that the future value of the claim is $300,000 (that is, before discounting the claim to its present value). E determines, after considering all available information and making reasonable assumptions, that the expected date of payment of the claim is Date X, which is reflected in the appraisal. Date X is a date after the third anniversary of D's date of death. E may claim a deduction for the present value of the claim as of D's date of death, determined by discounting $300,000 for the period from the date of death to

Date X, using the applicable Federal rate determined under section 1274(d) for the month in which D's death occurs, compounded annually.

(vi) Example 6: Discounting amount to be paid for series of payments payable over a period that does not end on or before the third anniversary of the decedent's death. Pursuant to the terms of a divorce and separation agreement entered on June 1 of Year 1, Decedent (D) is obligated to make annual payments of $100x to Claimant (C) on September 1 of year 1 and each September 1st thereafter until D has made a total of 10 such payments. D dies on December 1 of Year 5 after having made the first five annual payments required under the agreement. The applicable Federal (mid-term) rate determined under section 1274(d) for the month in which D's death occurs, compounded annually, is 2.00%. The executor of D's estate (E) may claim a deduction with respect to C's claim on D's Form 706 under the special rule contained in paragraph (d)(4) of this section because the deductible amount can be ascertained with reasonable certainty. E computes the discounted deductible amount of the claim by adding the undiscounted amount of the three payments that will be made before the third anniversary of D's death ($300x) to the discounted amounts of the two payments that will be made after the third anniversary of D's death. Accordingly, the amount deductible for the claim equals $483.866x ($300x + $92.843x + $91.023x). The individual calculations for the present values of the payments in the last two years of the payment obligation are shown in table 1 to this paragraph (d)(7)(vi).

Table 1 to paragraph (d)(7)(vi)

	(1)	**(2)**	**(3)**	**(4)**	**(5)**
	t	**1+i**	**1/(1+i)**	**$[1/(1+i)]^t$**	**$[1/(1+i)]^t \times 100x$**
Year 9	3.75	1.0200	0.980392	0.928430	92.843x
Year 10	4.75	1.0200	0.980392	0.910226	91.023x

* * * * *

(f) Applicability date. The rules of this section apply to the estates of decedents dying on or after [date of publication of the final rule in the **Federal Register**].

Par. 3. Section 20.2053-3 is amended by:

1. Redesignating paragraphs (d) and (e) as paragraphs (e) and (f), respectively.
2. Adding a new paragraph (d).
3. Revising newly redesignated paragraph (f).

The addition and revision read as follows:

§20.2053-3 Deduction for expenses of administering estate.

* * * * *

(d) Interest expense incurred in administering the estate--(1) Interest payable under section 6601 on unpaid tax--(i) Section 6166 interest. As used in paragraph (d)(1) of this section, the phrase "section 6166 interest" means interest payable under section 6601 on unpaid estate tax deferred under section 6166. This includes interest accruing on an installment or other payment under section 6166 during the period of an extension of time for making that payment under section 6161(a)(2)(B). Section 6166 interest is not deductible pursuant to section 2053(c)(1)(D).

(ii) Non-section 6166 interest. As used in paragraph (d)(1) of this section, the phrase "non-section 6166 interest" means interest payable under section 6601 or under state or local law other than section 6166 interest. Non-section 6166 interest that accrues on or after the decedent's date of death on any unpaid tax or penalties may be deductible to the extent permitted by §20.2053-1 and this section. For purposes of paragraph (d)(1) of this section, penalties include any unpaid additions to tax, additional taxes, and penalties. When non-section 6166 interest accrues on unpaid estate tax deferred under section 6161 or section 6163, the interest expense is actually and necessarily incurred in the administration of the estate for purposes of paragraph (a) of this section because the extension was based on a demonstrated need to defer payment. When non-section 6166 interest accrues on and after the date of a decedent's death on any unpaid tax or penalties in connection with an underpayment of tax or a deficiency, the interest expense generally is actually and necessarily incurred in the administration of the estate for purposes of paragraph (a) of this section.

(iii) Exception. Notwithstanding paragraph (d)(1)(ii) of this section, non-section 6166 interest accruing on unpaid tax and penalties on and after the decedent's date of death, whether in connection with a deferral, underpayment, or deficiency, is not actually and necessarily incurred in the administration of the estate for purposes of paragraph (a) of this section and is not deductible to the extent the interest expense is attributable to an executor's negligence, disregard of applicable rules or regulations (including careless, reckless, or intentional disregard of rules or regulations) as defined in §1.6662-3(b)(2) of this chapter, or fraud with intent to evade tax. Interest expense is attributable to an executor's negligence, disregard of applicable rules or regulations, or fraud with intent to evade tax to the extent that the underlying deferral, underpayment, or deficiency, is attributable to such conduct by the executor. Similarly, even when the underlying deferral, underpayment, or deficiency is not attributable to such conduct by the executor, the interest expense is attributable to an executor's negligence, disregard of the rules or regulations, or fraud with intent to evade tax to the extent the subsequent accrual of interest is attributable to such conduct by the executor.

(iv) Examples. The following examples illustrate the application of this paragraph (d)(1). In each example, the decedent (D) dies on October 1, Year 1, and the estate tax return is due July 1 of the following calendar year, Year 2. In each example, except as expressly stated, there is no negligence, disregard of applicable rules or regulations, or fraud on the part of the executor.

(A) Example 1. On July 1, Year 2, the executor of D's estate (E) timely files the estate tax return based on values determined in good faith and pays $500,000, which is the estate tax shown on the return. Upon examination, the Internal Revenue Service (IRS) makes an adjustment to the value of an asset includible in the gross estate, resulting in a $25,000 increase in estate tax due. E initially contests the adjustment, but eventually agrees to the assessment of the deficiency in the amount of $25,000. Interest on the deficiency is payable under section 6601 in the amount of $X. E makes a payment in satisfaction of the assessed deficiency and interest. For purposes of paragraph (a) of this section, the interest expense in the amount of $X is considered actually and necessarily incurred in the administration of D's estate, and its deduction reduces the amount of the deficiency.

(B) Example 2. The executor of D's estate (E) files the estate tax return and pays the estate tax shown on the return ($500,000) on July 1 of Year 3, one year after the due date. On August 1, Year 3, the IRS assesses interest on the unpaid tax under section 6601 in the amount of $X, assesses late filing and late payment penalties in accordance with section 6651 in the amount of $Y, and issues a notice and demand for payment of $X and $Y. On August 1, Year 4, E makes payment to the IRS of $Z, which is the total amount due for $X and $Y, as well as interest that accrued on these amounts from August 1, Year 3, to August 1, Year 4, payable under section 6601. The facts establish that E's failure to timely file the return and timely pay the tax and failure to pay the assessed interest and penalties within the period provided in the notice and demand is a result of E's disregard of the rules for filing the return and paying the tax and any assessed penalties. Under the facts in this paragraph (d)(1)(iv)(B), neither the interest payable under section 6601 that accrued on the unpaid tax before notice and demand nor the interest that accrued on the unpaid tax and penalties after notice and demand is an expense that is actually and necessarily incurred in the administration of D's estate for purposes of paragraph (a) of this section.

(C) Example 3. Prior to D's death, the IRS had assessed an income tax deficiency against D for the 2009 tax period in the amount of $75,000, and penalties in the amount of $X. The assessed tax and penalties remained unpaid on D's date of death. On July 1, Year 2, the executor of D's estate (E) timely files the estate tax return and timely pays the estate tax shown on the return to be due. On the same date, E also pays all claims against and liabilities of the estate, except for the assessed income tax deficiency and penalties for the 2009 tax period. Despite E's awareness that the estate had sufficient liquidity and funds to satisfy all estate liabilities, including the 2009 income tax deficiency and penalties, E does not pay the assessed income tax deficiency, penalties, and accrued interest until July 1, Year 4. E's failure to pay the assessed income tax deficiency and penalties for the 2009 tax period is a result of E's disregard of applicable rules or regulations. Even though the underlying income tax deficiency is not attributable to E's negligence, disregard of applicable rules, or fraud with intent to evade tax, the interest that accrued after July 1, Year 2, on the assessed deficiency and penalties is attributable to E's disregard of applicable rules or regulations. Accordingly, the post-July 1, Year 2, interest is not an expense that is actually and necessarily incurred in the administration of D's estate.

(2) Interest expense on certain loan obligations of the estate. Interest on a loan entered into by the estate to facilitate the payment of the estate's tax and other liabilities or the administration of the estate may be deductible depending on all the facts and circumstances. To be a deductible administration expense, interest expense must arise from an instrument or contractual arrangement that constitutes indebtedness under applicable income tax regulations and general principles of Federal tax law. In addition, the interest expense and the loan to which interest expense relates must satisfy the requirement of §20.2053-1(b)(2) that they are bona fide in nature based on all the facts and circumstances. Further, both the loan to which the interest expense relates and the loan terms must be actually and necessarily incurred in the administration of the decedent's estate and must be essential to the proper settlement of the decedent's estate. See paragraph (a) of this section. If the facts and circumstances establish that

the interest expense arises from an instrument or contractual arrangement that constitutes indebtedness under general principles of Federal tax law, factors that collectively may support a finding that the interest expense also satisfies the additional requirements under §20.2053-1(b)(2) and paragraph (a) of this section include, but are not limited to, the following:

(i) The interest rate on and the terms of the underlying loan (whether between related or unrelated parties), including any prepayment penalty, are reasonable given all the facts and circumstances and comparable to an arms-length loan transaction;

(ii) The underlying loan is entered into by an executor of the decedent's estate acting in the capacity of executor or, if no executor is appointed and acting, the person accountable for satisfying the liabilities of the estate;

(iii) The lender properly includes amounts of paid and/or accrued interest (including original issue discount as determined under sections 1271 through 1275 and the regulations in this part under those sections, such as original issue discount attributable to stated interest that is treated as part of the stated redemption price at maturity because it is not payable at least annually) in gross income for Federal income tax purposes, particularly if the lender is a family member of the decedent, a related entity, or a beneficiary of the decedent's estate or trust (as defined in §20.2053-1(b)(2)(iii));

(iv) The loan proceeds are used to satisfy estate liabilities that are essential to the proper settlement of the estate, including, but not limited to, the Federal estate tax liability;

(v) The loan term and payment schedule correspond to the estate's anticipated ability to make the payments under, and to satisfy, the loan, and the loan term does not extend beyond what is reasonably necessary;

(vi) The only practical alternatives to the loan are the sale of estate assets at prices that are significantly below-market, the forced liquidation of an entity that conducts an active trade or business, or some similar financially undesirable course of action;

(vii) The underlying loan is entered into when the estate's liquid assets are insufficient to satisfy estate liabilities, the estate does not have control (within the meaning of section 2701(b)(2)) of an entity that has liquid assets sufficient to satisfy estate liabilities, the estate has no power to direct or compel an entity in which it has an interest to sell liquid assets to enable the estate to satisfy its liabilities, and the estate's assets are expected to generate sufficient cash flow or liquidity to make the payments required under the loan;

(viii) The estate's illiquidity does not occur after the decedent's death as a result of the decedent's testamentary estate plan to create illiquidity; similarly, the illiquidity does not occur post-death as a deliberate result of the action or inaction of the executor who then had both knowledge or reason to know of the estate tax liability and a reasonable alternative to that action or inaction that could have avoided or mitigated the illiquidity;

(ix) The lender is not a beneficiary of a substantial portion of the value of the estate, and is not an entity over which such a beneficiary has control (within the meaning of section 2701(b)(2)) or the right to compel or direct the making of the loan;

(x) The lender or lenders are not beneficiaries of the estate whose individual share of liability under the loan is substantially similar to his or her share of the estate; and

(xi) The decedent's estate has no right of recovery of estate tax against, or of contribution from, the person loaning the funds.

* * * * *

(f) Applicability date. The rules of this section apply to the estates of decedents dying on or after [date of publication of the final rule in the **Federal Register**].

Par. 4. Section 20.2053-4 is amended by:

1. Revising paragraphs (b)(1)(iv), (b)(2), and (c)(1)(iv) and (v), the second sentence of paragraph (c)(3), paragraph (d)(5), and paragraph (d)(7)(iii) introductory text.

2. In paragraph (d)(7)(iii), Examples 1 through 9 are designated as paragraphs (d)(7)(iii)(A) through (I), respectively.

3. In newly designated paragraph (d)(7)(iii)(A), removing "decision," and "§20.2053-3(c) or §20.2053-3(d)(3)" adding "decision." and "§20.2053-3(c) or (d)(3)" in their places, respectively.

4. In newly designated paragraphs (d)(7)(iii)(B) and (C), removing "payment,", "Example 1", and "§20.2053-3(c) or §20.2053-3(d)(3)" and adding "payment.", "paragraph (d)(7)(iii)(A) of this section (Example 1)", and "§20.2053-3(c) or (d)(3)" in their places, respectively.

5. In newly designated paragraph (d)(7)(iii)(D), removing "defendants,", "Example 1", and "§20.2053-3(c) or §20.2053-3(d)(3)" and adding "defendants.", "paragraph (d)(7)(iii)(A) of this section (Example 1)", and "§20.2053-3(c) or (d)(3)" in their places, respectively.

6. In newly designated paragraph (d)(7)(iii)(E), removing "payment,", "Example 1", and "§20.2053-3(c) or §20.2053-3(d)(3)" and adding "payment.", "paragraph (d)(7)(iii)(A) of this section (Example 1)", and "§20.2053-3(c) or (d)(3)" in their places, respectively.

7. In newly designated paragraph (d)(7)(iii)(F), removing "claims," and "§20.2053-3(c) or §20.2053-3(d)(3)" and adding "claims." and "§20.2053-3(c) or (d)(3)" in their places, respectively.

8. In newly designated paragraph (d)(7)(iii)(G), removing "enforceability," and adding "enforceability." in its place.

9. In newly designated paragraph (d)(7)(iii)(H), removing "estate," and adding "estate." in its place.

10. In newly designated paragraph (d)(7)(iii)(I), removing "satisfaction," and adding "satisfaction." in its place.

11. Adding paragraph (d)(7)(iii)(J).

12. Revising paragraph (f).

The revisions and addition read as follows:

§20.2053-4 Deduction for claims against the estate.

* * * * *

(b) * * *

(1) * * *

(iv) The value of each such claim against the estate is supported by a written appraisal document to be filed with the Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, or successor form, and the written appraisal document--

(A) Adequately reflects post-death events that have occurred prior to the date on which a deduction is claimed on an estate's Form 706;

(B) Reports, considers, and appropriately weighs all relevant facts and elements of value as are known or are reasonably determinable at the time of the appraisal, including the underlying facts of the claim against the estate, potential litigating risks, and the current status of the claim and procedural history;

(C) Takes into account post-death events reasonably anticipated to occur;

(D) Identifies an expected date or dates of payment (for purposes of determining the applicability of the present value limitation in §20.2053-1(d)(6));

(E) Explains in detail the methods and analysis that support the appraisal's conclusions;

(F) Is prepared, signed under penalties of perjury, and dated by a person who is qualified by knowledge and experience to appraise the claim being valued and is not a family member of the decedent, a related entity, or a beneficiary of the decedent's estate or revocable trust (as those terms are defined in §20.2053-1(b)(2)(iii)), a family member of a beneficiary or a related entity as to a beneficiary (as those terms would be defined in §20.2053-1(b)(2)(iii) if references therein to the decedent were replaced with a reference to such beneficiary, and without regard to the limitations in §20.2053-1(b)(2)(iii) based on the decedent's date of death), or an employee or other owner of any of them; and

(G) Includes a statement providing the basis for the person's qualifications to appraise the claim being valued;

* * * * *

(2) <u>Limitation on deduction</u>. The deduction under this paragraph (b) is limited to the value of the related claims or particular assets included in decedent's gross estate. <u>See</u> §20.2053-1(d)(6)(v) for the impact of the present value limitation.

* * * * *

(c) * * *

(1) * * *

(iv) The value of each such claim against the estate is supported by a written appraisal document to be filed with the Form 706, <u>United States Estate (and Generation-Skipping Transfer) Tax Return</u>, or successor form, and the written appraisal document--

(A) Adequately reflects post-death events that have occurred prior to the date on which a deduction is claimed on an estate's Form 706;

(B) Reports, considers and appropriately weighs all relevant facts and elements of value as are known or reasonably determinable at the time of the appraisal, including the underlying facts of the claim against the estate, potential litigating risks, and the current status of the claim and procedural history;

(C) Takes into account post-death events reasonably anticipated to occur;

(D) Identifies an expected date or dates of payment (for purposes of determining the applicability of the present value limitation in §20.2053-1(d)(6));

(E) Explains in detail the methods and analysis that support the appraisal's conclusions;

(F) Is prepared, signed under penalties of perjury, and dated by a person who is qualified by knowledge and experience to appraise the claim being valued, and is not a family member of the decedent, a related entity, or a beneficiary of the decedent's estate or revocable trust (as those terms are defined in §20.2053-1(b)(2)(iii)), a family member of a beneficiary or a related entity as to a beneficiary (as those terms would be defined in §20.2053-1(b)(2)(iii) if references therein to the decedent were replaced with a reference to such beneficiary, and without regard to the limitations in §20.2053-1(b)(2)(iii) based on the decedent's date of death), or an employee or other owner of any of them; and

(G) Includes a statement providing the basis for the person's qualifications to appraise the claim being valued;

(v) The total amount deducted by the estate under paragraph (c) of this section does not exceed $500,000 (<u>see</u> §20.2053-1(d)(6)(v) for the impact of the present value limitation);

* * * * *

(3) * * * Assume that each claim is paid within three years after the decedent's death, and that the value of each claim is determined from a written appraisal document that meets the requirements of paragraph (c)(1)(iv) of this section. * * *

(d) * * *

(5) Claims founded upon a promise--(i) In general. To be deductible, a claim founded on a promise must represent a personal obligation of the decedent existing at the time of the decedent's death, and the claim must be enforceable against the decedent's estate. In addition, except with regard to pledges or subscriptions (see §20.2053-5), the deduction for a claim founded upon a promise or agreement is limited to the extent that the promise or agreement was bona fide and in exchange for adequate and full consideration in money or money's worth; that is, the promise or agreement must have been bargained for at arm's length and the price must have been an adequate and full equivalent reducible to money value.

(ii) Decedent's promise to guarantee a debt. A deduction for a claim founded upon a decedent's agreement to guarantee a debt of another is a claim founded on a promise and is subject to the limitation in paragraph (d)(5)(i) of this section. For purposes of section 2053, a decedent's agreement to guarantee a debt of an entity in which the decedent had an interest at the time the guarantee was given satisfies the requirement that the agreement be in exchange for adequate and full consideration in money or money's worth if, at the time the guarantee was given, the decedent had control (within the meaning of section 2701(b)(2)) of the entity. Alternatively, this requirement is satisfied to the extent the maximum liability of the decedent under the guarantee did not exceed, at the time the guarantee was given, the fair market value of the decedent's interest in the entity. The bona fide nature of the decedent's agreement to guarantee a debt of a family member, a related entity, or a beneficiary (as defined in §20.2053-1(b)(2)(iii)) is determined in accordance with §20.2053-1(b)(2)(ii). For a claim otherwise deductible under this paragraph (d)(5)(ii), the estate's right of contribution or reimbursement will reduce the amount deductible in accordance with §20.2053-1(d)(3). Payments made pursuant to the decedent's guarantee of a debt are deductible only to the extent that the debt for which the guarantee is given has not been taken into account in computing the value of the gross estate under §20.2053-7 or otherwise.

* * * * *

(7) * * *

(iii) The claimant (C) is not a family member, related entity, or beneficiary of the estate of decedent (D), unless otherwise provided, and is not the executor (E).

* * * * *

(J) Example 10: Guarantee. On Date 1, D entered into a guarantee agreement with Bank (C) to secure financing for a closely-held business (LLC) in which D had a controlling interest. LLC was solvent at the time LLC executed a promissory note in the amount of $100x in favor of C. Prior to D's death, LLC became insolvent and stopped making payments on the note. After D's death, C filed a claim against D's estate for payment of the remaining balance due under the note and E paid the full amount due. Although E had a right of contribution against LLC for primary payment of the indebtedness, LLC was insolvent and no part of the debt was collectible at the time E deducted the payment. D's estate may deduct the amount paid to C in satisfaction of D's liability under the guarantee agreement. The guarantee agreement is considered to have been contracted for an adequate and full consideration in money or money's worth. The result would be the same if D did not have control of LLC as long as the fair market value of D's interest in the LLC on Date 1 was at least $100x.

* * * * *

(f) Applicability date. The rules of this section apply to the estates of decedents dying on or after [date of publication of the final rule in the **Federal Register**].

Paul J. Mamo,

Acting Deputy Commissioner for Services and Enforcement.

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